

**BEFORE
THE ILLINOIS COMMERCE COMMISSION**

Commonwealth Edison Company	:	
	:	Docket No. 00-0259
Petition for expedited approval of	:	
implementation of a market-based	:	
alternative tariff, to become effective on	:	
or before May 1, 2000, pursuant to	:	
Article IX and Section 16-112 of the	:	
Public Utilities Act	:	
	:	(cons.)
Central Illinois Public Service Company	:	
Union Electric Company	:	
	:	Docket No. 00-0395
Petition for approval of revisions to	:	
market value tariff, Rider MV	:	
	:	
Illinois Power Company	:	
	:	Docket No. 00-0461
Proposed new Rider MVI and	:	
Revisions to Rider TC	:	

INITIAL BRIEF OF THE AMEREN COMPANIES

Central Illinois Public Service Company, d/b/a AmerenCIPS, and Union Electric Company, d/b/a AmerenUE, (the "Ameren Companies" or "Ameren") submit their Initial Brief in this matter. For all the reasons stated herein, the Ameren Companies' proposed revisions to their respective market value tariff riders should be approved.

This proceeding requires the Commission to make a choice as to the best available means of determining market value for the purposes of calculating transition charges and setting prices under Power Purchase Option ("PPO") tariffs. The stakes are high. As several witnesses made clear, without contradiction, an understated or overstated market value will adversely affect the development of meaningful retail competition. The record also shows that the existing Neutral Fact Finder ("NFF") methodology is severely flawed, and has produced market value figures

significantly below prices at which power and energy trade in the market. As a result, the NFF is hampering the development of retail electric competition in this State.

The Ameren Companies have offered a market index solution to the determination of market value. There is general agreement that a market index approach is preferable to the NFF, but there are a number of disputes as to how to calculate the market value of power and energy in the context of a market index alternative. Some parties have offered adjustments to the Ameren market value approach, arguing that without such adjustments, the Ameren index approach will understate the market value of power and energy at retail. The Commission must bear in mind that the failure to reflect any one or more of those adjustments will not make the Ameren index approach less accurate than the NFF methodology. The Ameren index approach already produces a higher market value than the NFF approach; hence, if, as these parties contend, the Ameren index approach understates market value, the NFF result is even worse than previously believed. Even without the adjustments that have been proposed in this case, the Ameren index approach is far superior to the NFF model, and should be approved.

I. Overview of Applicable Statutory Provisions and Requirements

AmerenCIPS and AmerenUE are electric utilities within the meaning of Section 3-105 of the Illinois Public Utilities Act (the "Act"), 220 ILCS 5/3-105 (1999). Both are wholly-owned subsidiaries of Ameren Corporation. The Ameren Companies each have a delivery services tariff on file with the Commission. Both companies have riders in effect to collect transition charges pursuant to Section 16-102 of the Act under Rider TC, and both offer PPO service (under Rider PPOS) pursuant to Section 16-110 of the Act.

To calculate the transition charge under Rider TC and to price service under Rider PPOS, both companies have in effect a Rider MV, which determines the market value of power and

energy. Pursuant to the Commission's order in Docket No. 99-0121, the Ameren Companies' initial delivery services tariff proceeding, Rider MV employs the market values determined by the NFF.

The flaws in the NFF approach are well known, and there has been widespread criticism of the NFF methodology. The record shows that the NFF values currently in effect understate the market value of power and energy, which has the effect of making it more difficult for meaningful competition to develop. Ameren Ex. 1.0, pp. 6-7. The NFF methodology, however, is dictated by Section 16-112 of the Act, and the Commission does not have the authority to alter that methodology. 220 ILCS 5/16-112 (1999).

The Commission does have the authority to approve the use of a methodology other than the NFF methodology. Specifically, Section 16-112(a) provides that the Commission may approve a "tariff that provides for the determination of the market value for electric power and energy as a function of an exchange traded or other market traded index, options or futures contract or contracts applicable to the market in which the utility sells, and the customers in its service territory buy, electric power and energy. . . ." 220 ILCS 5/16-112(a) (1999).

The Ameren Companies have proposed to implement a market value index approach for application in their service territories. In Docket No. 00-0395, the Ameren Companies submitted a revised Rider MV for both AmerenCIPS and AmerenUE that would calculate market value as a function of the "Into Cinergy" prices for on-peak periods and as a function of other market traded transactions for off-peak periods. As discussed herein, the market traded data that are employed in the proposed riders are applicable to the Ameren market, and will provide a more accurate measure of the market value of power and energy bought and sold in the Ameren market than the NFF methodology provides.

The Ameren Companies believe that use of a more accurate measure of market value will contribute to the development of meaningful competition in Illinois. If, for example, the market value, and therefore the price for power under the PPO, is set too low, alternative suppliers will be less able to compete on the basis of price. Alternatively, if the market value is set too high, Illinois electric utilities will undercollect transition charges. Ameren Ex. 1.0, pp. 2-3. The Ameren Companies believe, and the record shows, that a market-traded index approach will produce the most accurate result, and therefore, will produce the best conditions for fostering competition, with the fairest transition charge recovery. Id.

A. On-Peak Issues

1. Appropriate Hub (Into ComEd v. Into Cinergy)

The Ameren Companies propose to use “Into Cinergy” to measure market value during on-peak periods based on a variety of considerations. Ameren Ex. 2.0, pp. 10-11. First, the “Into Cinergy” price, with an appropriate locational basis adjustment, will accurately reflect the price of electricity delivered to Ameren. Id. Second, use of an actively traded market, like “Into Cinergy”, will reduce, if not eliminate, the possibility of market manipulation. Id. Third, the Companies believe that using the “Into Cinergy” market will help promote competition throughout Illinois by providing a vibrant market for use as a risk management vehicle. Id.

Generally, the Ameren proposal is modeled on the methodology reflected in the currently effective ComEd tariff. The principal difference is that, where the Ameren proposal uses “Into Cinergy” prices, the ComEd model uses “Into ComEd” prices. This is because there is no publicly traded index for the “Into Ameren” market. Hence, Ameren proposes to use the regional “Into Cinergy” prices, adjusted to reflect Ameren-specific characteristics.

The use of "Into Cinergy" index data is appropriate because that regional index is applicable to the market in which power for the Ameren market is bought and sold. Mr. Eacret studied the daily prices posted in "Power Markets Week" for "Into Cinergy" and "Southern MAIN" to assess whether there is a correlation between the Into Cinergy and Into Ameren markets. Ameren Ex. 6.0, p. 1, Sch. 1 (conf). Into Ameren is a part of the Lower MAIN or Southern MAIN market, which makes the analysis of this data relevant. Daily data from Power Markets Week was compiled for the period May 3, 1999 through April 28, 2000. Id. Cinergy data was reported for each day in this period. Id. When Southern MAIN data was not available through Power Markets Week, Lower MAIN data from Bloomberg was used in its place. Id. The analysis showed that the correlation coefficient of these two data sets is .995 -- almost one-to-one. Accordingly, "into Cinergy" is applicable to the Ameren market, and satisfies the requirements of Section 16-112.

Notwithstanding the clear applicability of "Into Cinergy" to the Ameren market, Unicom Energy witness Braun contended that "Into ComEd" should be established as the uniform base index for calculating market values in the State of Illinois. None of the reasons offered by Mr. Braun is valid, and his proposal should be rejected.

Mr. Braun's first reason is that the Into ComEd market is the most liquid in Illinois. Unicom Energy provided no support for this assertion, but even if true it is not much of a distinction. Liquidity is still a major concern at the ComEd hub. As noted by ICC witness Zuraski, IIEC witness Bowyer, and New Energy witnesses O'Connor and Baumschriber, there is considerable concern about ComEd's ability to manipulate prices at that hub because of the lack of activity there. The liquidity at that hub might well be a good reason **not** to choose the ComEd market for a base index. Ameren will not enter that debate, except to state that liquidity concerns

about that hub are clearly a reason not to require its use elsewhere at this time. Experience may well demonstrate in the future that the Into ComEd hub is a viable mechanism for determining market value throughout Illinois, but that cannot be demonstrated today. Ameren Ex. 4.0, p.5.

As a second reason for choosing the ComEd hub, Mr. Braun argued that “non-Illinois hubs create difficult problems in translating non-Illinois prices into Illinois prices”. Ameren Ex. 4.0, pp. 5-6. He suggested that use of the Into ComEd hub would eliminate the need to add a basis adjustment for customers in the ComEd service territory. That may be true, but the basis adjustment problem for the rest of the state would be no better, if not worse.

Basis adjustments for Illinois Power and Ameren markets are calculated based on daily and forward data from one of the most liquid hubs in the country (Into Cinergy) and daily data from the less liquid Southern MAIN. Mr. Braun would propose substituting Into ComEd for Into Cinergy, resulting in the use of variables of lesser liquidity to calculate the basis. This would not be appropriate. Ameren Ex. 4.0, p. 6.

Ameren examined Price Waterhouse Coopers’ Next Day PowerTrax Index, which reports daily prices and volumes for the major hubs. Ameren Ex. 2.0, pp. 11-12. According to PowerTrax, for the period September 1, 1999 through August 31, 2000 an average of approximately 94 daily 50-MW contracts traded at the Cinergy hub each day. During the same period, an average of 6 daily 50-MW contracts traded at the ComEd hub each day. There were 45 days during the period when no daily Into ComEd contracts traded. Accordingly, it is clear that Into ComEd is far less liquid than Into Cinergy.

Lastly, Mr. Braun asserted that a single base index would “lay a solid framework for competition” and “be easier for ARES and customers to interpret and plan against”. That would be true only if his first two points were correct. Ameren Ex. 4.0, p. 6.

2. Manipulation/Thinness/Transparency of Electronic Trading Platforms

As is evident from the immediately foregoing discussion, there is considerable concern regarding liquidity. A market is said to be liquid if the instruments that are traded in that market can easily be sold at approximately current market prices. Ameren Ex. 2.0, p. 11. In a liquid market, large blocks of assets can be sold rapidly without significantly affecting market prices. Id. Electricity trading at the Cinergy hub meets this definition. Id.

The Ameren Companies propose that market values be determined for on-peak and off-peak periods based on data from electronic exchanges or published data that are accessible to market participants, in a manner substantially similar to that recently approved by the Commission for use by ComEd in the year 2000. Specifically, on-peak market prices would be determined using forward contract market data for electric energy delivered in the Into Cinergy hub from AltradeTM and Bloomberg PowerMatch, which are two real-time, Internet-based, on-line, electronic trading systems which post Into Cinergy hub forward contracts' market data. Ameren Ex. 2.0, pp. 4-5. These forward contracts' market data would be used to determine the on-peak market prices because the on-peak period is the most volatile pricing period.

Mr. Eacret explained how and why the AltradeTM and Bloomberg PowerMatch trading systems were selected for calculating on peak market prices. Ameren Ex. 2.0, pp. 6-7. To establish appropriate values for forward looking and stable TCs and MVs, a forward looking market value is needed. Id. The two options for forward-looking data are forward contract price quotes and futures market prices. Id. The forward quote is a price today for delivery and payment at a future date and pertains to a specific contract. The futures market is also a price today for delivery and payment at a future date, but it is established from a standardized contract listed for trading at an organized exchange. Id.

The most widely accessible, transparent, dynamically competitive market media available today for trading Into Cinergy hub forward contracts are the Altrade™ and Bloomberg PowerMatch trading systems. Id. The Altrade™ system in particular has been developed by established brokers as a viable trading tool. Id. The Altrade™ System is a powerful tool for multiple market participants, who can list forward price quotes and have them immediately visible to other market participants, who in turn can respond through counter bids and counter offers, ensuring that fair, competitive market values become established. Id. Bloomberg PowerMatch provides a second, independent source for arriving at competitive, fair market values. Id.

In sum, the Ameren Companies have selected a liquid index, without a data thinness problem, to be measured by means of reliable and accessible data sources.

3. Basis Adjustment

Locational basis represents the differences in prices of exactly the same product from one location to another. Based on data posted in "Power Markets Week" for "Into Cinergy" and "Southern MAIN" for the period May 1, 1999 through April 30, 2000, monthly locational bases were established for on-peak transactions.¹ The average of the monthly locational bases was approximately \$.68 per MWh. Ameren Ex. 2.0, p. 12.

While Ameren used an additive method, Staff witness Christ outlined a multiplicative method for determining basis adjustment. In most months, the difference in basis adjustments calculated using the additive method employed by Ameren as opposed to the multiplicative method is *de minimus*. In Schedule 2 to ICC Exhibit 4.0, Mr. Christ compared the differences between the multiplicative and additive methods for the period June 2000 through February 2001 using daily price data collected from June 1999 to February 2000. Based on Mr. Christ's figures,

the average difference between the methods was a \$2.42 premium to the additive method, or roughly 4% of the average underlying Cinergy forward price of \$60.89. Ameren Ex. 4.0, p. 3. Ameren prefers the additive method; however, Ameren will not object if the Commission requires use of the multiplicative method to achieve uniformity.

4. Data Hierarchies

B. Off-Peak (Use of Historical Data)

Market values for off-peak periods will be determined using historical prices as a proxy for formal prices. There is no applicable off-peak, regularly traded, forward market data, but there is not a significant level of volatility in off-peak prices. Ameren Ex. 4.0, pp. 3-4. Historical prices for the daily eight-hour off-peak periods from Monday through Friday for various reliability regions can be obtained from “Power Markets Week’s Daily Price Report,” which lists a range of daily spot market transactions. Id. The Ameren Companies will calculate the midpoint between the minimum and maximum trades for each day with reported prices, and a simple average of the midpoints for those days will be used as the monthly value for the off-peak market price. Id.

Unicom Energy witness Braun expressed concern that Ameren and Illinois Power use the same Southern MAIN off-peak data but reach different results. The data submitted by both Ameren and IP were intended primarily to demonstrate calculation methods. Ameren Ex. 4.0, p. 7. No attempt was made to verify that the same data was being used to demonstrate these methods. Id. In this case, Ameren was using data for the twelve months ended December 31, 1999. Illinois Power used data for the twelve months ended approximately May 1, 2000. Id. This explains the differences for the months of January through April. Differences in the

¹ It is not necessary to calculate a basis differential applicable to the off-peak period because the off-peak prices used (Southern MAIN) are directly applicable to the Ameren market.

remaining months are the result of minor variations in the Southern MAIN prices provided by the data sources used by Ameren and Illinois Power. Id.

Accordingly, while there are differences between the Ameren and IP results, it does not indicate a serious problem. Ameren would agree with Mr. Braun that to the extent possible the utilities should cooperate to ensure that data sources, which are supposed to be identical, actually are identical.

C. Other

III. Pricing and Market Definition Related Issues

A. Optionality Adjustment (Load Uncertainty)

New Energy witness Kagan recommended that the Ameren Companies use “Black’s model” to reflect an optionality component in the market value. Ameren agrees in principle with the concept of including a load-uncertainty adder in market values. However, Mr. Kagan’s suggestion to use Black’s model would require significant revision.

First, as Mr. Kagan notes, Black’s model assumes that the holder would only exercise the option when it was “in the money”, that is, when the strike price is lower than the market price for a call or when the strike price is higher than the market price for a put. Ameren Ex. 4.0, pp. 7-8. However, in this case, the option will be exercised only when the customer’s actual usage in an hour varied from that which was forecast. Id. This reduces the value of the option, but Mr. Kagan provided no support for his proposal to recognize this reduction in value by discounting the Black’s Model result by 25% to 50%. Id.

Second, again as Mr. Kagan notes, electricity price distributions are not consistent with the assumptions behind Black’s model. Id.

Third, Mr. Kagan described the inputs necessary to use Black's Model as readily available. However, the attempt here is to calculate an hourly option. What is the time to expiration of an hourly option? What is the forward price for a given hour a year in the future? What is the hourly price volatility? Id. These are all critical, but missing inputs.

Lastly, the value of such an option will depend on load volatility as well as price volatility and the correlation between the two. Id. Mr. Kagan did not address how Black's model would be modified to address these issues. Id.

B. Energy Imbalance Adjustment

C. Planning Reserve Adjustment

New Energy witnesses O'Connor and Bramshreiber and CILCO witness Lancaster proposed that the market value reflect the "transmission requirement" of regulatory capacity in the Ameren tariffs. Ameren is not opposed to the inclusion of a component in the market value that reflects the fact that Ameren requires RES and CSMs to have a 15% reserve margin. Under Ameren's recently filed OATT Schedule 4A, reserve capacity is available from Ameren on a daily basis to RES supplying retail load. Ameren Ex. 5.0, p. 7. Ameren proposed that the pricing for this component of the market value be taken from Ameren's OATT Schedule 4A. Id. Using the pricing and methodology specified in Schedule 4A, the Period A MVs that Ameren has previously submitted would be modified accordingly. Id.

D. Capacity Backed Adjustment

E. Non-Firm Adjustment

F. Adjustment to Historical Off-Peak Prices ("Dump Energy" Issue)

G. Load Shaping for Off-Peak Prices

H. Other

IV. Time Period and Notice Related Issues

A. Periods A/B v. 12 Month Rolling Average

Ameren will determine MVs and TCs twice each year. There will be two separate periods for each year, Applicable Period A and Applicable Period B. MVs and TCs for Applicable Period A will be filed on or before the 10th business day of April of each year. Ameren Ex. 3.0, pp. 8-9. Applicable Period A will cover a twelve month period starting with June and continuing through the following May. Id. MVs and TCs for Applicable Period B will be filed on or before the 10th business day of July of each year. Id. Applicable Period B will cover a nine-month period starting with September and continuing through the following May. Id.

Ameren witness Hock explained why market value rates and transition charges should be calculated for customer classes in both March and June. Ameren Ex. 3.0, pp. 3-4. Historically, and particularly so in the last few years, summer on-peak prices have been extremely volatile and price levels have been significantly higher than during the non-summer months. Id. From year to year, the magnitude of these differences can also vary considerably. The best method to reduce this price volatility risk is to use forward price quotes as close to the summer as possible to capture the available market information, while still meeting customers' needs for sufficient planning time after MVs and TCs have been publicized. Id. Without accounting for the on-peak seasonal price volatility, there can be considerable risk for all market participants. Id. Off-peak market prices are more consistent throughout the year and do not exhibit the volatility that on-peak prices do, but they should still be updated to capture the best available information when establishing the off-peak prices. Id. By performing these calculations at two different points in time, customers will have more accurate price signals. Better price signals should enhance the development of the competitive market in Illinois. Id.

Nicor opposed Ameren's use of Periods A/B. Periods A and B have significantly different prices because (as regulatory commissions have recognized for a long time, well before the advent of retail competition) the market values for power and energy differ between the periods. Ameren Ex. 5.0, p. 3. The recognition of different prices for different time periods sends proper price signals to users. Id. Nicor witness Bailey asserted, however, that reflecting the actual differences between summer and non-summer values in actual summer and non-summer prices "removes some customer incentive to procure competitive power." In other words, Nicor believes that a customer in non-summer months paying prices based on non-summer market values will not have an incentive to switch to another provider unless the customer is instead required to pay non-summer charges that reflect weighted average summer and non-summer values (i.e., we overstate the non-summer value).

Nicor's stated concern underestimates the sophistication of both marketers and users. The use of a Period B does not hinder competition and does not remove the incentive to procure competitive power. In fact, since the Period B market values (MVs) more accurately reflect the price at which a RES should be able to serve a customer during the non-summer period, the Period A/B structure should promote more efficient competition than Ameren's current NFF based market value tariff. Ameren Ex. 5.0, pp. 3-4. Nicor's point (as Ameren understands it), is that transition charges will be higher during non-summer months if the lower, more accurate non-summer values are used. That may be so, but that does not mean that competition will be harmed. Customers evaluating competitive options in February are unlikely to base their decisions on the economic advantages of a switch in February alone. Rather, customers are likely to look forward over a longer period. Id.

Ameren notes that Nicor's proposal would not only lower transition charges in non-summer months, but also would increase transition charges in summer months by understating the value of power and energy during summer months. Ameren Ex. 5.0, p. 4. Thus, if, as Nicor contends, Ameren's method decreases incentives during non-summer months, it would be equally true that Nicor's method would decrease incentives during summer months, when power is at its most expensive. Id. Ameren believes that incentives will not be decreased during either period. Again, customers will be making longer-term decisions, and marketers will explain the long-term ramifications to customers. That is part of marketing. You cannot fool customers by understating transition charges in a particular month or series of months.

Moreover, Ameren notes that Period B also provides added flexibility for customers who are considering switching to delivery services for the first time. Customers electing the PPO are not required to commit to twelve months of service, but only to a term that expires at the next June meter read. Ameren Ex. 5.0, pp. 4-5. At that time, the customer has the opportunity to reevaluate the available power supply options including a RES, a twelve month PPO agreement, or bundled service. Whether the customer takes service from a RES or under the PPO during Period B, the pricing of the transition charge should enable the customer to save money when compared to the bundled rate. Id. These savings provide an incentive for customers to switch to delivery services and procure power at a competitive market price. Id.

Mr. Bailey recommended that Ameren use the IP 12-month rolling average approach. Ameren prefers the Period A/B structure over the 12-month rolling average approach for several reasons. First, the additional accuracy afforded by the 12-month rolling average must be weighed against the additional complexity that a customer must sort through in order to make power supply decisions. Ameren Ex. 5.0, p. 5. The 12-month rolling average does not afford as much

additional accuracy as would first appear. Id. By far, the summer months have the highest prices and the greatest price volatility. Id. Therefore, the best time to determine annual prices is as close to the summer months as possible. Id. This is exactly what is done with the Period A/B methodology. Id. Since there is very little price volatility during the non-summer months, the accuracy of the prices for this time period is not greatly affected by not recalculating each month. The increased complexity impacts not only customers but suppliers and host utilities as well. Suppliers, who have an increased administrative burden associated with continuously updating pricing models and marketing plans, have greater difficulty providing accurate proposals to customers. Customers also must continuously monitor pricing information in order to make accurate decisions. Finally, suppliers and customers have only a short window of time in which to make decisions in response to the updated pricing. Id.

Second, there would most likely be cases where the Period A/B methodology would provide more accurate pricing information. Id., pp. 5-6. For example, a twelve-month forward view in September or October may include very inaccurate forward price information for the following summer. Id. Since, as already described, the summer months heavily influence the twelve month prices, a customer may choose not to switch to delivery services because of the unacceptable level of risk. Id.

Finally, the differences in the cost of implementing the Period A/B methodology and the 12-month rolling average are substantial. Id., p. 6. There is a higher cost of implementation with the 12-month rolling average due to system changes and customer service. Id. More complex tariff modeling in the billing system and modifications to the Competitive Pricing System, a stand alone system used to calculate TCs, are examples of system changes that would make the cost of implementation higher with the 12-month rolling average methodology. Id. Impacts to customer

service include increased staffing of the call centers to answer customer inquiries, training of call center personnel, and more frequent mailings. Id. The 12-month rolling average methodology also places a greater burden on the ICC Staff who must review informational filings every month.

Ameren does not dispute the utility of a 12-month rolling average methodology. However, for the reasons stated above, Ameren prefers the Period A/B methodology, and believes that, overall, it provides the best solution for the customers and suppliers in the Ameren service territory.

B. Notice Period for PPO Customers

C. Notice Period for Delivery Service Customers

D. Other

V. Other Issues

A. Transitional Issues

B. Availability of PPO Service to Customers with Transition Charge of Zero

C. Other

WHEREFORE, for all the reasons stated herein, the Ameren Companies request that the Commission approve the revisions to Rider MV proposed in their Petition in Docket No. 00-0395.

Respectfully submitted,

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